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Supreme Court of the United States

October Term, 1973

No. 73-1479

ETSON B. JEFFRESS,

Petitioner,

vs.

JOSEPH L. KRAMER and BEATRICE F. KRAMER,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

The Petitioner Etson B. Jeffress prays that a writ of certiorari issue to review a decision of the United States Court of Appeals for the Sixth Circuit. That court, by a decision filed January 11, 1974, reversed a decision of the district court which had denied Respondents' motion for summary judgment seeking a declaration of liability on the part of Jeffress to Champion Home Builders Co. (Champion) under Section 16(b) of the Securities Exchange Act of 1934 and granted Jeffress' cross-motion to dismiss the complaint. In reversing the district court, the Court of Appeals held that there was a purchase and sale of Champion stock by Jeffress, an insider of Champion, within a period of less than six months giving rise to 16(b) liability (rejecting the district court's finding that the "purchase" occurred more than six months prior to the sale), despite the fact that the sale was in a public offering pursuant to a Registration Statement prepared by Champion and cleared by the Securities and Exchange Commission, in accordance with the Securities Act of 1933, and despite the fact that Champion would be unjustly enriched by such a recovery.

Opinions Below

The opinion of the Court of Appeals is appended hereto as Appendix A to this Petition, and is reported at CCH Fed. Sec. L. Rep. ¶ 94,347. It is not yet officially reported. The opinion of the district court is appended hereto as Appendix B and is reported at 352 F. Supp. 1081.

Jurisdiction

The decree of the Court of Appeals of which review is sought was entered on January 11, 1974. The court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

Questions Propounded

(1) Whether Section 16(b) of the Securities Exchange Act of 1934 is applicable where the sale by the insider was in a public offering pursuant to a Registration Statement, cleared by the SEC under the Securities Act of 1933, in which all material facts concerning the issuer (Champion) and concerning the transactions in issue were disclosed.

(2) Whether in connection with an exchange of stock involving a corporate merger there was a firm commitment and the opportunity for speculative abuse giving rise to a "purchase" within the meaning of said Section 16(b) at the time said merger was approved by the issuer's board of directors.

(3) Whether recovery under said Section 16(b) should be denied on the further ground that its allowance under these circumstances would unjustly enrich Champion by reducing the price it had agreed to pay for Jeffress' company.

Statutes Involved

Section 3(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a), provides in pertinent part:

> When used in this chapter, unless the context otherwise requires—
>
> * * *
>
> 13) The terms "buy" and "purchase" each include any contract to buy, purchase or otherwise acquire.
>
> 14) The terms "sale" and "sell" each include any contract to sell or otherwise dispose of.

Section 16(b) of the Securities Exchange Act of 1934, U.S.C. 78p(b), provides in pertinent part:

> For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period less than six months * * * shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not purchasing the security sold for a period exceeding six months. * * * This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

In addition, it is contended that the construction adopted by the Court of Appeals of said Section 16(b) of the Securi-

ties Exchange Act of 1934 (hereinafter called the "Exchange Act") conflicts with the Congressional purpose behind the Securities Act of 1933 ("Securities Act"), 15 U.S.C. § 77v(a).

Statement of the Case

Jeffress had founded and was the sole owner of Concord Mobile Homes, Inc. (Concord), an Indiana corporation specializing in the recreational trailer business. In January of 1968 he was contacted by and entered into discussions with officers of Champion concerning a possible merger of the two companies. Champion was a Michigan based manufacturer of mobile homes, its common stock being listed on the American Stock Exchange. Jeffress had at one time been associated with Champion before starting his own business (30-31a).*

The merger discussions resulted in a handshake agreement on February 17, 1968, subject to approval of Champion's board of directors, whereby Jeffress was to sell to Champion all of the outstanding stock of Concord (120 shares) which he owned in exchange for 105,000 shares of the common stock of Champion (80a).

Four days after the handshake agreement was reached the Champion board of directors—on February 21, 1968—accepted the Jeffress offer and approved the acquisition of Concord in exchange for 105,000 shares of Champion common stock (Ex. 8) which would make Jeffress a 13% owner of Champion's outstanding common stock (Ex. 9, p. 3). As soon as the merger was approved Jeffress was invited into the Board meeting and discussions were immediately commenced to effectuate the merger (Ex. 8, p. 3). From that moment on he was treated as a major stockholder

* Citations with the suffix "a" are to pages of the Appendix filed with the Court of Appeals, a certified copy of which has been filed in this Court. Exhibits will be referred to as "Ex".

of Champion and became privy to "inside" information to the same extent as any other insider. On that date Champion common stock closed on the American Stock Exchange at $24.87, thus setting the price for the Concord shares at $2,611,350. This price, *i.e.*, the number of Champion shares exchanged for the Concord shares, never changed even though by April 17, 1968, when the formal contract was executed, the market value of those 105,000 shares had increased by more than $1 million, indicating the firmness of the handshake agreement on its approval by the Champion board of directors.

The minutes of the Champion board meeting of February 21, 1968 were signed by the President (who was also the Chief Executive Officer of Champion) and not, as is customary, by Champion's secretary. These minutes were therefore a formal enunciation by Champion that, except for a formal contract to be subsequently executed, there was a firm contractual arrangement pursuant to which Champion would exchange 105,000 shares of its common stock for all the outstanding Concord common stock which was owned by Jeffress. The district court so held.

It was understood that Champion would, as soon as practicable, have a public offering of its common stock pursuant to a Registration Statement to be filed under the provisions of the Securities Act, and that Jeffress would participate, along with certain officers and directors of Champion, by offering approximately 25% of the stock of Champion acquired by him in the merger. In fact, Mr. Jeffress was not only offered the opportunity to join in the public offering, he was *required* to do so, since other major shareholders did not wish to disturb the balance of stock ownership between Jeffress and the other major stockholders participating in the secondary offering (Ex. 2, p. 4).

The closing of the transaction, which was strictly a formality, occurred on April 17, 1968, and what the district court aptly described as a "boiler plate contract" (B 20a)* was signed on that date but "as of February 29, 1968," which was the end of the fiscal year of both companies (and being eight days after the Champion board had accepted the Jeffress offer). Jeffress was elected a director of Champion on June 19, 1968 (7a).

An initial Registration Statement was prepared and filed with the SEC on July 1, 1969 (Ex. 7). However, the Registration Statement did not become effective until September 5, 1968 (Ex. 6), when the public offering commenced, culminating in the sale and delivery on September 12, 1968 of the shares being offered by Champion and the selling stockholders, including Jeffress. In the interim there had been a 100% stock dividend declared by Champion, resulting in Jeffress owning a total of 210,000 shares, of which he sold 50,000 shares in the public offering on September 12, 1968. A total of 350,000 shares were offered for sale, of which 100,000 were sold by Champion and 200,000 by other officers and directors of Champion (Ex. 6, p. 15).

The sale of said common stock in the public offering pursuant to the Registration Statement was, of course, made with full disclosure of all material facts pertaining to the Company, including full disclosure of the circumstances surrounding the acquisition of all of Concord's outstanding shares by Champion. Each of the selling stockholders certified to the S.E.C. that "The sale of the Common Stock proposed to be sold by us pursuant to the Registration Statement is not prompted by any information concerning the Company which is not set forth in the Prospectus." (Ex. 5). The timing of the public offering was determined by Champion and the underwriters (45a, 64a).

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* Citations with the prefix "A" or "B" are to pages of the Appendix hereto.

This suit was commenced by Champion in the Eastern District of Michigan in December 1968, after a stockholder's suit (subsequently dismissed) was started in the Southern District of New York. The Respondents thereafter intervened in this action.

The District Court, in granting Jeffress' cross-motion for summary judgment, found that the parties had reached agreement on the esential terms of the exchange agreement on February 21, 1968, when the Champion board approved the prior February 17, 1968 handshake agreement. Since this was more than 6 months prior to the sale on September 12, 1968, the district court held that "the transactions do not fall within the statutory period" and "there can be no liability on defendant's part for any profit made" (B 21a and 22a). The Court took note of other defenses interposed by defendant but, in view of its finding that the "purchase" and "sale" were not within six months, the Court was not obliged to reach these other issues (B 22a).

Respondents-Intervenors appealed to the Court of Appeals, Sixth Circuit. Champion did not join in the appeal.

The Court of Appeals reversed, holding that the purchase by Jeffress of Champion stock did not occur until the formal closing on April 17, 1968 when the shares were physically delivered. The Court of Appeals went on to decide other issues not reached by the district court, to wit:

(a) It summarily dismissed as of "no moment" the fact the sale was pursuant to a Registration Statement (A 12a);

(b) The doctrine of unjust enrichment was held to be inapplicable (A 12a and 13a).

The Court of Appeals did not determine the issues raised by Jeffress' counterclaim under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Reasons for Granting the Writ

Prior to the decision of the Court of Appeals, Sixth Circuit, in the present case no appellate federal court, so far as Petitioner is aware, had ever imposed Section 16(b) liability in a situation where the sale was in a public offering pursuant to a Registration Statement cleared by the SEC pursuant to the Securities Act.* The Registration Statement is the basic requirement of the Securities Act designed to provide complete disclosure to the public of all material facts pertaining to a public offering of securities. The SEC has established detailed, comprehensive guidelines, rules and regulations for the preparation of Registration Statements, and all such statements must clear the SEC before becoming effective. An "insider" participating with the issuer in a public offering, as in this case, must sign the Registration Statement and is bound by law to make full disclosure of all material facts under penalty of exposure to civil and criminal liability as provided in the Securities Act (Sections 11 and 24). If the Court of Appeals decision is upheld it will subject a participant in such an offering, who has fully complied with all 1933 Act requirements, to liability under Section 16(b) of the 1934 Act *to the issuer*—the very corporation which is the registrant and has prime responsibility for the content of the Registration Statement.

Moreover, Jeffress is, in this case, in effect being required to repay Champion part of the consideration received by him from the sale of his company, Concord,

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* In a district court decision, *Provident Securities Co.* v. *Foremost-McKesson, Inc.*, 331 F.Supp. 787 (N.D. Calif. 1971) involving a sale pursuant to a Registration Statement, the court refused to allow a 16(b) recovery. Also, the Court of Appeals, 4th Circuit has recently expressed the view that where a proxy statement (not nearly as comprehensive as a Registration Statement) gave complete information on the subject company "the potential for unfairness and any basis for invoking the statute [16(b)] disappears" (*Gold* v. *Sloan*, 486 F. 2d 340 (4th Cir. 1973) at p. 349).

because he allowed a part of his Champion common stock received in the merger to be sold in the public offering on a date selected by Champion and the underwriters which, it is now claimed, was within 6 months of the "purchase." Such a holding is clearly not required in order to protect the public against the short term speculation at which Section 16(b) was directed and, moreover, in view of the absence of any potential for speculative abuse, the holding is inconsistent with this Court's holding in *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582 (1973).

This case is unique in another respect in that it not only involves an unorthodox *sale* pursuant to a Registration Statement, it also involves an unorthodox *purchase*,—by acquisition of stock in a corporate merger. However, it is not a question of *whether* there was a purchase; it is a question of *when* the purchased occurred. Petitioner believes that the Court of Appeals has misapplied the pragmatic test adopted by this Court in *Kern County* in determining the purchase date. The district court found, on substantial supporting evidence, that there was a firm commitment for the exchange of Jeffress' holdings in Concord for 105,000 shares of Champion when the Champion Board approved Jeffress' offer at its meeting on February 21, 1968—more than 6 months before the sale. Jeffress was at that time assured of obtaining the Champion stock in exchange for his company and was in a position to speculate against the contract, had he so desired (cf. *Booth* v. *Varian Associates*, 334 F. 2d 1, 4 (1st Cir. 1964), cert. den. 379 U.S. 961), which is all that should be required to give rise to a "purchase". The determination of the date of "purchase" under Section 16(b) does not involve ordinary notions of contractual rights and duties (*Bershad* v. *McDonough*, 428 F. 2d 693 at 697 (7th Cir. 1970); it involves consideration of whether and, in this case, *when* there arose an opportunity for the sort of speculative abuse the statute was designed to prevent. The

district court's finding that the purchase within the meaning and intent of Section 16(b), occurred on February 21, 1968 should not be disturbed.

POINT I.

The imposition of liability in this instance raises a question as to the interrelationship of Section 16(b) of the Exchange Act and the provisions of the Securities Act designed to afford protection to the public through the vehicle of the Registration Statement.

Section 16(b) was enacted for the purpose of preventing unfair use of "inside" information for personal profit by an officer, director or beneficial owner of 10% or more of any class of equity securities of a company the securities of which are registered on a national securities exchange (15 U.S.C. § 78p(b)). To achieve this goal Congress provided that any profit realized by an insider from a purchase and sale of the issuing company's securities within an arbitrary period of six months is recoverable by the issuer.

The courts have emphasized that the section is directed at short-term speculation by insiders, in in-and-out trading (*Blau* v. *Max Factor & Co.*, 342 F. 2d 304 (9th Cir. 1965), cert. den. 382 U.S. 892 or as stated by this Court, in *Reliance Electric Co.* v. *Emerson Electric Co.*, 404 U.S. 418 (1972) at p. 422), the purpose was to take "the profits out of a class of transactions in which the possibility of abuse was believed to be intolerably great".

In the common cash-for-stock purchase followed by the usual sale on a securities exchange, there is no difficulty in applying the "crude rule of thumb," or technical test to determine Section 16(b) liability. However, in unusual or "unorthodox" transactions (mergers, conversions and consolidations) a judicial conflict developed in the application of Section 16(b),—some courts having adopted the technical, mechanistic test, without regard to the underlying statutory purpose of Section 16(b), and others hav-

ing adopted a pragmatic test confining the application of the statute to situations which Congress obviously sought to meet in enacting Section 16(b). *Ferraiolo* v. *Newman*, 259 F. 2d 342 (6th Cir. 1958), cert. den. 359 U.S. 927 (Stewart, J.) was the leading case rejecting a "black letter rubric" and adopting the pragmatic test. This Court in *Kern County Land Co.* v. *Occidental Petroleum Corp., supra* has resolved this conflict in the various circuits by adopting the pragmatic test so as to confine the application of the statute to situations where the statutory purpose would be served and where "the particular type of transaction involved is one that gives rise to speculative abuse" (*Kern County Land Co.* v. *Occidental Petroleum Corp., supra*, 411 U.S. 503 at 515.

Applying that test here, and even assuming arguendo that the Court of Appeals correctly held that Jeffress "purchased" his Champion stock on April 17, 1968 (instead of February 21, 1968), the question is raised as to whether the possibility of speculative abuse was "intolerably great" when Jeffress sold his Champion stock in the public offering less than six months later. In other words, where the sale is pursuant to a Registration Statement, affording all the protection and remedies of the Securities Act which requires disclosure of all material facts, should the issuer corporation which is the acquiring corporation in a merger be permitted to invoke Section 16(b) of the 1934 Act? This, it is submitted, is an "unresolved question under an important federal statute" which warrants the granting of certiorari. cf. *Reliance Electric Co.* v. *Emerson Electric Co., supra*, 404 U.S. at p. 422.

The Court of Appeals gave very little attention to this question, stating merely that—

> The fact that the sale was made pursuant to a registration statement is of no moment. If registration were enough to dissolve liability, the legislative intent would be thwarted. A registration statement

would not provide the intimate information that an insider such as Jeffress relied on.

The Court of Appeals decision reveals a surprising misconception of a public offering, through a Registration Statement, under the Securities Act. The decision refers to the "inside" information allegedly available to Jeffress, and the Court concludes that Jeffress' knowledge of a stock split coupled with increased earnings enabled him to take advantage of inside information in "timing the sale to maximize profits in a rising market" (A 12a).

Aside from the fact that the timing of the public offering was not within Jeffress' control, the information concerning the stock split and increased earnings was, of course, fully disclosed in the Registration Statement (Ex. 6). This clearly was not "inside" information at the time of the sale.

What the Court of Appeals overlooked, of course, is that the whole purpose of the Registration Statement is to insure the full disclosure of all *material* information. As was stated by Professor Loss, Securities Regulation, 2nd Ed., Chapter 1(A) at page 21:

> "Then too, there is the recurrent theme throughout these statutes of disclosure, again disclosure, and still more disclosure. Substantive regulation has its limits. But 'The truth shall make you free'."

Moreover, to suggest that Jeffress and the other offering stockholders, because of inside information, were able to time the public offering "to coincide with peak market value" and "to maximize profits" (A 11a and 12a) is not only not supported by the record but reveals a misunderstanding of the procedure in such public offerings. The underwriter and the issuer will, of course, attempt to time the offering in a rising market, if possible, so that the offering will be successful. They could hardly be expected to do otherwise. It does not follow, however, that in so

doing they were in any way using, let alone *mis*-using, inside information. General market conditions as well as the earnings record of the issuing corporation will usually dictate the timing. But the important thing is that all *material* information concerning the issuer and the stock offering is disclosed to the purchasing public in the Registration Statement and Prospectus—the very antithesis of the short term, in-and-out, speculative trading situation with which Section 16(b) of the Exchange Act is concerned.

Section 16(b) was designed to prevent the insider from taking advantage of information available to him by virtue of his insider status in order to obtain speculative profit. It was not designed to force an insider to forego legitimate profit in a situation in which inside information could not have been employed to his benefit.

Thus, this Court in the *Kern County* case absolved *Occidental* from liability for the profit it realized on the exchange of its Old Kern stock for Tenneco preferred stock by not classifying the exchange as a "sale" under Section 16(b), where Occidental did not engineer or control the exchange. So too, Jeffress, though a participant in the public offering of Champion stock, did not engineer or control the offering or its timing, and any knowledge of the business which he possessed, if it was of a material nature, was necessarily disclosed in the Registration Statement.

Respondents never have, except by innuendo, challenged the Champion Registration Statement. Standing in the shoes of Champion, they were in no position to do so. They are thus in the position of urging Section 16(b) recovery by the Corporation which prepared the Registration Statement, dictated the timing of the sale and which would be unjustly enriched to the extent of any recovery in this action. Can it seriously be contended that this is a type of transaction which "the statute is designed to prevent"? (*Ferraiolo* v. *Newman*, *supra*, 259 F.2d 342

(6th Cir. 1958), cert. den. 359 U.S. 927 (1959). We think not. To apply the statute here would truly require the mechanistic approach to Section 16(b) which this Court has condemned.

POINT II.

The proper application of the pragmatic test adopted by this court in *Kern County* requires affirming the district court's finding that the "purchase" occurred more than 6 months prior to the sale.

There has developed an apparent conflict in the interpretation of the *Kern County* decision and in the application of the pragmatic test adopted in that case to be applied in "unorthodox" transactions.

In the recent Fourth Circuit decision in *Gold* v. *Sloan,* 486 F.2d 340 (October 19, 1973), the majority reversed the distrist court holding imposing Section 16(b) liability on an officer and director of corporation A who received stock in a merger with corporation B and thereafter within six months sold the stock so acquired, based on a finding that he was merely a nominal director, with no access to inside information at the time of the merger. In that case the majority considered the possibility of speculative abuse *after* the merger as being irrelevant in determining whether there was a purchase within the meaning of Section 16(b). "The possibility of abuse test applies only to one transaction, the exchange of stock pursuant to a merger" (486 F.2d at p. 349).

In this case the Court of Appeals, Sixth Circuit, has directed its attention solely to the possibility of abuse *after* the merger and, in so doing, it has not considered the possibility of speculative abuse as having significance in determining whether and, more important, *when* the purchase occurred; it has focused on the period after the merger and leading up to the sale in the public offering,

ignoring (as previously discussed) the fact that the *sale* under these circumstances could not possibly involve any use or abuse of inside information by Jeffress.

No one disputes the fact that, applying the pragmatic test, there was a "purchase" by Jeffress of Champion stock. Here the question is not *whether* there was a purchase but *when*, it being Petitioner's contention that the application of the pragmatic test to the facts in this case requires affirming the district court's holding that the "purchase" occurred more than 6 months prior to the sale. Had the Court of Appeals applied the pragmatic test to the purchase, rather than the sale, and had it discarded the notion that rigid rules of contract law control, it would have been led to agree with the district court that—

> Not only were the parties bound by their agreement as of February 21, 1968, but Jeffress, by participation in the directors' meeting at that time, became privy to information disclosed at that meeting and the public was led to believe that Jeffress was an "insider" from that time forward (B 20a).

The district court correctly disposed of the argument that the formal agreement signed April 17, 1968 was the significant date by referring to the letter dated March 26, 1968 of plaintiff's then attorney, Mr. Sullivan, to Mr. Grenier of Champion (Ex. 13) wherein Mr. Sullivan stated:

> "This is a fairly long but typical agreement * * * [We] are not familiar with Concord's organization or operations and basically all we have done is to prepare an agreement which we think would be applicable to this kind of acquisition." (113a)

This is clear and convincing proof that the agreement was truly "boiler plate," involving no extensive negotiations concerning its provisions, the essential terms having already been agreed upon.

As of the February 21st date Jeffress not only had inside knowledge of the Concord operation (as recognized by the Court of Appeals, A 11a), he also worked closely with the management of Champion from that day forward and was in every practical sense an insider. Implicit in the relationship of Champion as buyer and Jeffress as seller, was an undertaking to furnish each other with the basic facts about their respective companies for inclusion in the form of representations in the contract ultimately to be signed and in connection with the preparation of the Registration Statement. Jeffress furnished all material information about the Concord Company and about himself and, in return, Jeffress received information about Champion. During the entire period after the Champion Board approved the merger Jeffress, having a firm commitment to acquire Champion stock at a set price, was in a position to speculate against the contract, as an insider, had he so desired. Therefore, applying the pragmatic test required by this Court's decision in *Kern County*, the "purchase," for Section 16(b) purposes, occurred on February 21, 1968, or more than 6 months prior to the sale in the public offering.

POINT III.

To allow recovery would permit Champion to become unjustly enriched at Jeffress' expense; accordingly, the doctrine of unjust enrichment should be applied to prevent injustice.

Jeffress in his answer invoked the doctrine of unjust enrichment as a defense and counterclaim, based on the fact that Champion not only *required* him to include a portion of the Champion common stock in the registered public offering and itself, in collaboration with the underwriters, chose the date and timing of the public offering, but (perhaps more significantly) based also on the fact that the Respondents-Intervenors on behalf of Champion now seek

a recovery which would "change the deal" by allowing Champion, in effect, to secure ownership of Concord for a price considerably less than the price agreed upon. To allow recovery would enable Champion unjustly to regain, at Jeffress' expense, part of the consideration Champion agreed to pay for the Concord common stock owned by Jeffress. This, it is submitted, would constitute unjust enrichment to Champion.

To permit recovery to Champion in this case would allow acquiring companies to negotiate acquisitions in exchange for their securities rather than cash, insist on a registered public offering of at least part of the negotiated consideration within a six month period, and then turn around and sue for recovery of the profit, if any, on the public offering, thereby securing, in effect, a reduction in the negotiated price of the acquisition.

Perhaps Jeffress was badly advised when he allowed 50,000 Champion shares owned by him to be included in the Registration Statement. But Champion, as the issuer primarily responsible for that Registration Statement and who now seeks to recover any profit Jeffress may have realized on such sale, itself timed the sale to occur within six months of the April 17, 1968 date of the formal contract signing.

As stated by the court in *Provident Securities Co.* v. *Foremost-McKesson, Inc., supra*, 331 F.Supp. at 792, to allow recovery under these circumstances "would be to perpetrate rather than correct an inequity." The court in the *Provident Securities Co.* case, without specifically so stating, has in effect applied the equitable doctrine of unjust enrichment to prevent recovery under Section 16(b). It is respectfully urged that this doctrine should be applied here.

CONCLUSION

For the reasons set forth above, the petition for a writ of certiorari should be granted and the judgment of the Court of Appeals for the Sixth Circuit reversed.

Respectfully submitted,

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Appendix A

No. 73-1341

UNITED STATES COURT OF APPEALS

FOR THE SIXTH CIRCUIT

CHAMPION HOME BUILDERS CO., a Michigan Corporation,
Plaintiff,

JOSEPH L. KRAMER, *et al.*,
Intervenor-Plaintiffs-Appellants,

v.

ETSON B. JEFFRESS,
Defendant-Appellee.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF MICHIGAN

Decided and Filed January 11, 1974.

Before PHILLIPS, Chief Judge, and EDWARDS and MCCREE, Circuit Judges.

PHILLIPS, Chief Judge. This action was brought on behalf of a corporation to recover short-swing profits from the sale of stock by an insider. The issue on appeal is whether the purchase of the stock, within the meaning of § 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78 p(b), occurred within a period of less than six months prior to its sale.

Appendix A

In an opinion published at 352 F.Supp 1081 (E.D. Mich. 1973), the District Court held that more than six months had elapsed between the purchase and sale and dismissed the action. We reverse.

Joseph and Beatrice F. Kramer were intervenor-plaintiffs in the District Court. They are stockholders of the Champion Home Builders Co. (Champion). On behalf of the corporation they seek to recover certain profits realized by the defendant-appellee Jeffress from a sale of Champion stock allegedly within six months after its purchase.

The District Court denied the Kramers' motion for summary judgment on the issue of liability and granted Jeffress' motion for summary judgment of dismissal. The Kramers appealed. Champion has not appealed.

The case arose from the acquisition of Concord Mobile Homes, Inc. (Concord) by Champion. This acquisition was effected by a purchase of 100 per cent of the Concord stock, owned by Jeffress, in exchange for 105,000 shares of Champion stock (13 per cent of the total). After the exchange Jeffress became an officer and director of Champion. Pursuant to a public offering, and along with three other major officer-director-shareholders, Jeffress sold a portion of his Champion stock. The Kramers as shareholders of Champion seek to recover on behalf of Champion the profits from this sale as provided for under § 16(b) of the Securities Exchange Act of 1934. Section 16(b) provides as follows:

> "For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt

previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

The sole question before this court is to determine when Jeffress purchased the Champion stock.[1] The date of the sale is not in dispute.

On February 17, 1968, Jeffress entered into a handshake agreement with the President and the Treasurer of Champion. This agreement was subject to the approval of Champion's Board of Directors. On February 21, 1968, the Champion Board approved the acquisition of Concord and authorized negotiations to that end. The minutes of that meeting were signed by Champion's President.

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[1] The lower court did not reach Jeffress' counterclaim under § 10(b) of the Act and Rule 10b-5, nor do we.

Appendix A

The parties entered into a 25 page written agreement and plan of reorganization on April 17, 1968. This agreement was approved by the Champion Board on April 24, 1968. Pursuant to a public offering, and after the stock had split two-for-one, Jeffress and three other officer-director-shareholders sold part of their stock on September 12, 1968.

If the Champion stock was "purchased" on February 21, 1968, the date of the resolution, as Jeffress contends and as held by the District Court, liability under the section will not attach. On the other hand, if the stock was "purchased" on April 17, 1968, the date the agreement and plan of reorganization was executed, liability will attach for any insider swing profits realized by Jeffress.

The District Court held that the purchase date of the Champion stock was February 21, 1968. The court reasoned that the resolution of the Board of Diretors was an acceptance of Jeffress' offer to sell and created a mutually binding contract. This "contract" was held to be a purchase within the meaning of § 16(b). We disagree.

Section 3(a)(13) of the Act, 15 U.S.C. § 78c(a), defines "purchase" so as to include "any contract to buy, purchase or otherwise acquire." As said by then Ciricuit Judge Potter Stewart, "Every transaction which can reasonably be defined as a purchase will be so defined, if the transaction is of a kind which can possibly lend itself to the speculation encompassed by § 16(b)." *Ferraiolo* v. *Newman*, 259 F.2d 342, 345 (6th Cir. 1958), *cert. denied*, 359 U.S. 927 (1959).

The Supreme Court, speaking through Mr. Justice Stewart, has stated that "where alternative constructions of the terms of § 16(b) are possible, those terms are to be given the construction that best serves the congressional purpose of curbing short-swing speculation by corporate insiders" *Reliance Electric Co.* v. *Emerson Electric Co.*,

404 U.S. 418, 424 (1972). This holding was reaffirmed in *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582, 595 (1973).

The definition of these terms is a matter of federal law. *See, e.g., Tcherepnin* v. *Knight*, 389 U.S. 332, 337-38 (1967); *Blau* v. *Lehman*, 368 U.S. 403, 413-14 (1962); *Bershad* v. *McDonough*, 428 F.2d 693, 696 (7th Cir. 1970), *cert. denied*, 400 U.S. 992 (1971). "The phrase 'any purchase and sale' in § 16(b) is therefore not to be limited or defined solely in terms of commercial law of sales and notions of contractual rights and duties." 428 F.2d at 697. The transaction must be examined primarily in terms of federal securities law, and the analysis must focus on and be consistent with the congressional mandate of curbing insider short-swing speculation. "The question thus becomes one of balancing the respective advantages and disadvantages of each contended for 'purchase' date and determining which one, if held to be the date of purchase, would be more likely to lend itself to the abuses the statute was designed to protect against." *Booth* v. *Varian Associates*, 334 F.2d 1, 4 (1st Cir. 1964), *cert. denied*, 379 U.S. 961 (1965).

With these considerations in mind, we now turn our attention to the transaction of February 21, 1968. The holding of the District Court was as follows:

> "The court finds that on February 21 the parties had reached a meeting of the minds on the essentials of their exchange agreement and that if matters had thereafter bogged down in the drafting of a formal contract, either party could have sued to enforce the contract or for its breach. Since this was merely a purchase of stock by Champion, all that was needed to bind the corporation to the deal was the approval of the Board of Directors. This approval was formally given at the February 21 meeting. Jeffress, as the seller of his own stock, was similarly bound by

the aceptance of his offer of sale. Under the cases the parties were thus bound and defendant Jeffress then became the 'beneficial owner' and an insider." 352 F.Supp. 1081, 1083, (E.D. Mich. 1973).

The resolution of the Board of Directors is as follows:

"RESOLVED, that the proposed acquisition by Champion Home Builders Co. of all the issued and outstanding shares of the common stock, no par value ('Concord Stock'), of Concord Mobile Homes, Inc. and [sic] Indiana corporation, from Etson B. Jeffress in exchange for 105,000 shares of the Common Stock, par value $1, of Champion Home Builders Co., is approved, and the President and/or the Treasurer of this corporation are hereby authorized and empowered to negotiate with Etson B. Jeffress and to enter into, on behalf of this corporation, an agreement and plan of reorganization providing for the acquisition of Jeffress' Concord Stock in exchange for 105,000 shares of this corporation's Common Stock, par value $1, and providing for such additional terms and conditions (not to effect the foregoing) as they consider proper and in the best interests of the corporation;

"FURTHER RESOLVED, that the President and/or the Treasurer of this corporation are authorized and empowered to execute such agreement and plan of reorganization, to make any necessary modifications thereto, to sign any and all papers, documents and instruments necessary in connection with such agreement, and to do and perform any and all acts in connection therewith;

* * *

Jeffress has cited no authority, nor could we find any, to show that a Board of Directors' resolution is a "purchase"

within the meaning of § 16(b). To the contrary, the case law forces us to reach the opposite conclusion.

In *Blau* v. *Ogsbury*, 210 F.2d 426 (2d Cir. 1954), the court held that the holder of an option to buy stock becomes the beneficial owner when he incurs "an irrevocable liability to take and pay for the stock." *Id.* at 427. The court noted that the time when the insider's rights and obligations became fixed was controlling in the application of the statute. *Id.* In *Stella* v. *Graham-Paige Motors Corp.*, 232 F.2d 299 (2d Cir. 1956), *cert. denied*, 352 U.S. 831 (1956), the court was faced with a purchase contract which provided that the buyer could terminate the agreement if he could not obtain financing from a particular bank. The court, relying on *Ogsbury, supra*, held that the agreemen was not a purchase because the buyer had not incurred an irrevocable liability to take and pay for the stock. 232 F.2d at 301.

These cases alone, however, would not be controlling. Even a firm commitment to buy, standing alone, may not give rise to a purchase under § 16(b). In *Booth* v. *Varian Associates, supra*, there was an agreement that firmly committed the parties to an exchange of shares. The nature of the agreement left the price unfixed by providing that it would be determined at the closing market quotation on the day prior to closing, nearly three and a half years later. Moreover, the closing date could be accelerated by the issuing corporation and the buyers were insiders in this corporation. The court held that the purchase date was the date of actual exchange and not the date of agreement.

Finally, rights of ownership are pertinent factors in determining § 16(b) liability. In *Newmark* v. *RKO General, Inc.*, 425 F.2d 348, 356 (2d Cir. 1970), *cert. denied*, 400 U.S. 854 (1970), the court stated:

> "On May 3 or 4, 1967, RKO entered into an agreement which granted it a conditional right to purchase

more than 50% of Central's common stock at a fixed price, ensured that Central would be managed in accordance with its interests, and required a majority of Central shares to be voted in support of a merger it favored. This contract, we conclude, granted rights of ownership, particularly those rights most important to the speculative purchaser, so substantial as to make RKO a ten percent beneficial owner of Central at that time."

Similarly, the relinquishment of incidents of ownership is relevant to determining § 16(b) liability. In *Bershad* v. *McDonough*, 428 F.2d 693, 698 (7th Cir. 1970), *cert. denied*, 400 U.S. 992 (1971), the court stated:

"The circumstances of the transactions clearly indicate that the stock was effectively transferred, for all practical purposes, long before the exercise of the option. The $350,000 'binder' ostensibly paid for the option represented over 14% of the total purchase price of the stock. Granting the magnitude of the sale contemplated, the size of the initial commitment strongly suggests that it 'was not just a binder.' Cf. Blau v. Allen, 163 F.Supp. 702, 705 (S.D.N.Y. 1958). The extent of that payment represented, if not the exercise of the option, a significant deterrent to the abandonment of the contemplated sale. In addition, the reverse side of the 'Option Agreement' contained provisions for the transfer of the Cudahy stock, endorsed in blank, to an escrow agent pending completion of the transaction. At the same time, the McDonoughs delivered an irrevocable proxy to Smelting to vote the 272,000 shares at any regular or special shareholders' meetings. Within a few days, McDonough and one of his associate directors resigned and were replaced by representatives of Smelting's interests, including the Chairman of the

Board of Directors of Smelting, and the president and director of that corporation."

In light of the above considerations, we think that the resolution of the Board of Directors was, by its literal wording and in its legal effect, nothing more than an authorization to negotiate. The resolution set the purchase price and authorized and empowered the President and Treasurer of Champion to provide for such additional terms, conditions and modifications as were proper and in the best interests of the company. The entire transaction had been contingent on Concord's earnings at the end of the fiscal year, February 29, 1968. Negotiations continued after February 21 and culminated on April 17, 1968, with a 25 page agreement and plan of reorganization.

Jeffress incurred no irrevocable liability to take and pay for the Champion stock because he had not signed the Board minutes. Moreover, because there had been no consideration or contractual intent, the resolution cannot be viewed as giving him an option to buy Champion stock. Although resolutions such as the one before us are a prerequisite to corporate transactions of the type here involved, they are only a prelude to negotiations and may be rendered ineffective when the negotiations deadlock.

Additionally, we find no incidents of ownership arising from the resolution of the Board of Directors such as those that were present in *Newmark* or *Bershad, supra.* The resolution was no more than a license to bargain. We conclude that the resolution was not a contract in the traditional rights and obligations sense of the word. Nor can we conclude that such a tenuous posture is a "purchase" under § 16(b).

Our inquiry, however, does not end here. The transaction also must be examined to determine if there was the potential for speculative abuse.

Appendix A

At the time of the resolution Jeffress was not a statutory insider of Champion. He previously had owned no stock, nor was he an officer or director. The record does show that Jeffress had advanced knowledge of the merger. The Board had made a press release notifying the public of the proposed merger. The transaction is, therefore, unlike that of *Newmark, supra*, where RKO had not only a conditional right to purchase, but also advance knowledge of the impending merger.

Jeffress has argued that incorporation of the purchase price set in the February 21 resolution into the April 17 contract when the market price of Champion was rising, shows that the parties intended the agreement to be firm. The intent of the parties is irrelevant to determining § 16(b) liability. *Kern, supra.* Even assuming that intent was relevant, adherence to the earlier purchase price is not conclusive. It only shows that Jeffress would not settle for or Champion did not propose a lower price. It does not establish that the parties were bound to that price.

Jeffress also argues that other corporate documents refer to February 21 as being the significant date. This argument is not convincing. Jeffress referred to April 17 as the date he acquired beneficial ownership when he filed his Form 3 report to the SEC. Moreover, the parties cannot contract away their § 16(b) liability by agreements as to the purchase date. 15 U.S.C. § 78cc(a) provides:

> "Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void."

The record in this case compels us to conclude that Jeffress "purchased" the Champion stock on April 17, 1968, thereby becoming a beneficial owner and 13 per cent

shareholder of Champion. It was at that time that Jeffress incurred an irrevocable liability to take and pay for the Champion stock. This transaction gave rise not only to the potential for speculative abuse but also to actual abuse.

The record shows that when Jeffress was discussing the purchase of Concord in the preliminary negotiations, he valued it at about $4,000,000. After he was advised that Champion was not willing to give him cash for Concord, he agreed to sell it for Champion stock that was worth about $2,000,000 at the time. He knew that "the two companies was [sic] going to make the stock go up, or at least this is what [he] thought would happen." Jeffress intended to profit from this expected rise in Champion stock. He wanted to realize cash from the exchange as soon as possible. From this there arose an understanding between Jeffress and Champion that he along with three major officer-director-shareholders would participate in a stock offering later that year. The timing of that offer was to be mutually satisfactory to all and was to coincide with peak market value.

Shortly after Jeffress became a beneficial owner and 13 per cent shareholder of Champion, the Board of Directors approved a two-for-one stock split. Jeffress had advance knowledge of this. On June 19, 1968, as a result of an understanding, Jeffress was elected Secretary and Director of Champion. Thus, Jeffress was not only an insider because of his stock holdings, but also because of his position in the Company. We reemphasize that this occurred after April 17 and was not a result of the resolution of February 21.

Having been its owner, Jeffress had inside knowledge of the Concord operation. His position as an insider in Champion and his active role in its management gave him an intimate knowledge of internal corporate matters. He had access to all financial records of the company. The

evidence shows that the earnings rose from 10¢ per share for the quarter ending May 31, 1967. to 36¢ per share for the corresponding period in 1968.

Jeffress knew the effect that a stock split coupled with increased earnings would have in providing a rising market for his shares. He took advantage of this information and participated in the timing of the sale to maximize profits in a rising market situation. His participation was not limited solely to giving his approval as a director or signing the registration statement. It is logical to conclude that Jeffress was personally interested in obtaining the maximum amount of cash as soon as possible. This is precisely the kind of speculative abuse which the statute is designed to prevent.

The fact that the sale was made pursuant to a registration statement is of no moment. If registration were enough to dissolve liability, the legislative intent would be thwarted. A registration statement would not provide the intimate information that an insider such as Jeffress relied on.

Jeffress could have waited out the six month period. Instead he chose to maximize his profits as early as possible. In *Bershad* v. *McDonough*, *supra*, the Seventh Circuit Court of Appeals noted:

> "The thrust of the statutory scheme thus placed responsibility for meticulous observance of the provision upon the shoulders of the insider. He was deemed capable of structuring his dealings to avoid any possibility of taint and therefore must bear the risks of any inadvertent miscalculation." 428 F.2d at 696.

Jeffress has defended on the basis of his good faith and the doctrine of unjust enrichment. He contends that he was required to sell his stock and that it would be unjust

enrichment for Champion to regain, at his expense, part of the consideration for Concord. The record does not show that Jeffress was forced to sell his Champion stock. To the contrary, the record indicates that Jeffress wanted to sell to realize cash and actively participated in the timing of the sale so as to maximize his profits.

This defense is also based on a misinterpretation of § 16(b). Section 16(b) is designed to discourage short-swing transactions by insiders by taking away the profit and placing it in the hands of the corporation. By the very words of the statute, liability attaches regardless of the intention of the insider. The purpose of the statute is to protect the minority shareholders and the investing public. *Magida* v. *Continental Can Co., Inc.*, 231 F.2d 843, 846 (2d Cir.), *cert. denied*, 351 U.S. 972 (1956). Thus the absence of corporate damage is not a factor in assessing § 16(b) liability. Oftentimes the corporation will suffer no measurable damage or may even be an unwilling beneficiary of these profits. On the other hand, there are times when short-swing speculation by an insider may cause substantial corporate damage. "When officers and directors abuse their position to gain personal profits, the effect may be to cast a cloud on the corporation's name, injure stockholder relations and undermine public regard for the corporation's securities." *Diamond* v. *Oreamuno*, 24 N.Y.2d 494, 499, 301 N.Y.S.2d 78, 81-82, 248 N.E.2d 910 (1969).

While good faith and unjust enrichment are factors that can be relevant to classifying a transaction as a purchase or sale within the scope of § 16(b), it is clear that, once the transaction has been so classified, the section will impose strict liability. In *Bershad* v. *McDonough*, *supra*, the Seventh Circuit Court of Appeals stated:

> "In order to achieve its goals, Congress chose a relatively arbitrary rule capable of easy administration. The objective standard of Section 16(b) imposes strict liability upon substantially all trans-

> actions occurring within the statutory time period, regardless of the intent of the insider or the existence of actual speculation." 428 F.2d at 696.

We hold that Jeffress is liable for short-swing profits, if any, realized by him from the sale of the stock in question. The amount of liability is a matter for determination by the District Court on remand. The issues raised by Jeffress' counterclaim under § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 also are matters to be resolved on remand.

Reversed and remanded for further proceedings not inconsistent with this opinion.

Appendix B

UNITED STATES DISTRICT COURT

EASTERN DISTRICT OF MICHIGAN

SOUTHERN DIVISION

Civil Action No. 32106

—o—

CHAMPION HOME BUILDERS CO., a Michigan corporation,

Plaintiff,

JOSEPH L. KRAMER and BEATRICE F. KRAMER,

Intervenor-Plaintiffs,

vs.

ETSON B. JEFFRESS,

Defendant.

—o—

MEMORANDUM OPINION AND ORDER

The case now before this court presents us with the acquisition of one corporation (Concord Mobile Homes) by another (Champion Home Builders). That acquisition was accomplished via a purchase of 100% of the Concord stock, owned by Etson B. Jeffress, in exchange for 13% of Champion's stock. Mr. Jeffress was made a director of Champion subsequent to the sale. The major shareholders, including defendant, later sold as a part of the public offering portions of their holdings, pursuant to a previous agreement, selling proportional amounts in order to maintain the status quo.

This suit is brought by Champion at the instigation of two shareholders, the Kramers, to recover the profits that defendant Jeffress is alleged to have made through these

activities; the claim is made under § 16(b) of the Securities Exchange Act of 1934 (prohibiting "short-swing" profit-taking) [15 U.S.C.A. 78p(b)]. The Kramers have been declared by the court to be intervenor-plaintiffs for the reason that the other directors of the corporation were involved in the challenged transactions.

Section 16(b) of the Act [15 U.S.C.A. 78p(b)] provides that for the purpose of preventing the unfair use of information which may have been obtained, a person such as the defendant (a director or one who is a beneficial owner of more than 10% of the securities) who sells any of the securities, the beneficial ownership of which he has acquired within a period of six months from the time of the sale, is liable to the issuer of the securities for the profits realized on the sale of such securities.

Intervenor-plaintiffs' motion for summary judgment asserts that defendant sold the stock he acquired in the exchange within six months of its acquisition, thereby violating the provisions of § 16(b), and asks that the defendant be held liable for these transactions. Defendant has filed a cross-motion for summary judgment. In open court the parties agreed that the matter of liability was before the court for decision on the depositions, affidavits and exhibits submitted to the court.

There is no question as to the date of sale of the stock by Jeffress. It was September 12, 1968. The problem in this case is determining when Jeffress acquired "beneficial ownership" of the shares sold. Was it or was it not within the six month period prescribed by the statute?

Date of "Beneficial Ownership"

On February 17, 1968, a "handshake" agreement to exchange stock was entered into by Jeffress and Gerald Grenier and Henry George, Treasurer and President of Champion respectively, subject only to approval of the

Champion Board of Directors. A resolution regarding the exchange was adopted by the Board on February 21, 1968. The formal agreement was drawn up pursuant to the Board's direction and was executed on April 17, 1968.

Plaintiffs contend that the date of acquiring "beneficial ownership" is April 17, the date a formal detailed contract drawn up by the lawyers was executed by both parties. Defendant on the other hand contends that he acquired "beneficial ownership" on February 21, the date on which both parties were bound to exchange stock—105,000 shares of Champion for all of the shares of Concord—and the date the transaction was fully approved by the Board of Directors of Champion, the minutes of which were signed by its president. The question before the court is on which of these dates did the defendant Jeffress acquire beneficial ownership of the shares?

It appears that Section 16(b), as a result of recent cases, is being enforced against owners and directors in a less strict and mechanistic way:

> "The federal judiciary within the last few years has shifted from a strict and comparatively harsh objective interpretation of the section to a much more subjective approach, an analysis less concerned with the narrow letter of the law than with the particular facts at bar—in short, an approach less automatic and mechanistic and more fact-oriented and pragmatic." L. Lowenfels, Section 16(b): *A New Trend in Regulating Insider Trading*, 54 Cornell L. Rev. 45 (1968).

Ferraiolo vs. *Newman*, 259 F.2d 342 (6th Cir. 1958); *Blau* vs. *Max Factor & Co.*, 342 F.2d 304 (9th Cir. 1965); *Abrams* vs. *Occidental Petroleum Corp.*, 450 F.2d 157 (2nd Cir. 1971); *Provident Securities Co.* vs. *Foremost McKesson, Inc.*, 331 F. Supp. 787 (N.D. Cal. 1971). However, even a

technical and strict application of the statute leads to the conclusion that "beneficial ownership" was acquired by Jeffress on February 21, 1968.

The date of purchase or sale under which a person acquires "beneficial ownership" of stock under § 16(b) [15 U.S.C.A. 78p(b)] is not the date of transfer of the stock but the date on which the parties are irrevocably bound. *Newmark* vs. *RKO*, 425 F.2d 348 (2nd Cir. 1970); *Booth* v. *Varian Associates*, 334 F.2d 1 (1st Cir. 1964); *Stella* vs. *Graham-Paige*, 232 F.2d 299 (2nd Cir. 1956) and *Blau* vs. *Ogsbury*, 210 F.2d 426 (2nd Cir. 1954).

Newmark holds that the date of acquisition of a "conditional right to purchase . . . at a fixed price" is the date at which the purchaser became a beneficial owner. *Booth* postpones the date of "beneficial ownership" to the date at which the purchase price was fixed, holding that price is an essential part of the contract. *Stella* states beneficial ownership attaches when he "incurred irrevocable liability to take and pay for the stock." This did not arise until the closing, for prior to that time defendant was not irrevocably bound. *Blau* holds that the exercise of an option makes one a beneficial owner. Even though payment is postponed, the defendant became irrevocably liable.

The court finds that on February 21 the parties had reached a meeting of the minds on the essentials of their exchange agreement and that if matters had thereafter bogged down in the drafting of a formal contract, either party could have sued to enforce the contract or for its breach. Since this was merely a purchase of stock by Champion, all that was needed to bind the corporation to the deal was the approval of the Board of Directors. This approval was formally given at the February 21 meeting. Jeffress, as the seller of his own stock, was similarly bound by the acceptance of his offer of sale. Under the cases the parties were thus bound and defendant Jeffress then became the "beneficial owner" and an insider.

Appendix B

1. The parties had reached informal agreement earlier in February to exchange 105,000 shares of Champion for all of the stock of Concord.

2. Based on this informal agreement, the Board of Directors on February 21 formally approved acquisition of Jeffress' Concord stock in exchange for 105,000 shares of Champion stock. The Board minutes read as follows:

> "RESOLVED, that the proposed acquisition by Champion Home Builders Co. of all the issued and outstanding shares of the common stock, no par value ('Concord Stock'), of Concord Mobile Homes, Inc., an Indiana Corporation, from Etson B. Jeffress in exchange for 105,000 shares of the common stock, par value $1, of Champion Home Builders Co., is approved . . ."

3. Jeffress sat in on the Board meeting after approval had been given and discussed reorganization of the companies. The agreement that was discussed at this meeting was executed on April 17 and the signatures were approved by the Board on April 24.

4. The Prospectus issued for the public sale in September indicates on page 12 that "on February 21, 1968, the date on which the Board of Directors approved the acquisition of Mr. Jeffress' Concord stock [the price of Champion] was 12.44 per share, after adjustment to reflect the 100% stock distribution."

5. The proxy statement for the June stockholder meeting reported: "The acquisition of Mr. Jeffress' Concord stock in exchange for 105,000 shares of the company's $1 par value common stock was approved by the company's Board of Directors at a meeting held on February 21, 1968."

Appendix B

6. The Form 8-K Report to the Securities and Exchange Commission for the month of April also states that the Board approved the transaction with Jeffress on February 21, 1968.

7. A public announcement of the acquisition was issued on February 21, 1968.

Not only were the parties bound by their agreement as of February 21, 1968, but Jeffress, by participation in the directors' meeting at that time, become privy to information disclosed at that meeting and the public was led to believe that Jeffress was an "insider" from that time forward.

Plaintiff contends that there was much left to be done after its approval of the exchange transaction before defendant Jeffress could become a beneficial owner of its stock. As is common in transactions of this kind "boiler plate" must be brought together. The boiler plate contract was drafted by plaintiff's attorney and signed April 17 by all parties. The letter of the attorney to the plaintiff submitting the draft contract indicates that he considered that his contribution was to put on paper the normal and ordinary terms included in contracts of this kind when he states: "This is a fairly long but typical agreement . . . [We] are not familiar with Concord's organization or operations and basically all we have done is to prepare an agreement which we think would be applicable to this kind of acquisition."

The mere fact that the transaction was a four step transaction (1. Informal negotiations for acquisition of stock; 2. Formal approval of acquisition by the parties; 3. Inclusion of all boiler plate in an agreement and plan of reorganization document to be signed by the parties; 4. The issuance of the stock) does not change the fact that under the law Jeffress became a "beneficial owner" of the stock when the company formally approved the transaction on February 21.

Appendix B

Defendant contends that SEC Form 3 filed by Jeffress as required by § 16(a) [15 U.S.C.A. 78p(a)] indicates a date of April 17 as the date of acquiring the stock.

The Form 3 that was filed pursuant to SEC requirements by defendant stated he acquired the stock on April 17, 1968. But one not familiar with legal subtleties, and not thinking in terms of "beneficial ownership" would naturally tend to regard the signing of a formal agreement as the act of purchase. However, what a layman in an ordinary context regards as an act of purchase does not preclude the court from finding that beneficial ownership accrued at an earlier date.

The same can be said for all of the statements made in the course of these transactions that declare that the stock was acquired on April 17, as of February 29. The lay term of "acquisition" does not necessarily relate to a legal finding of when beneficial ownership accrued.

The record demonstrates that the action of the Champion Board of Directors on February 21, 1968 was the acceptance of an offer and the formation of a contract; this was not merely a proposal to negotiate. At this point in time the parties considered themselves bound, and were in fact bound, to a contract wherein each was to sell stock to the other. There was an offer by Jeffress on February 17, acceptance by the Board on February 21. Only the "boiler plate"—those terms that appear in every contract of this kind in approximately the same form—was left to be filled in by the formal agreement that was to be executed consistent with the decision of the Board. Purchase of stock is effectuated by Board action alone; the Board acted on February 21, thereby binding the corporation.

Defendant was irrevocably bound to a valid contract, and thereby became the beneficial owner of 13% of the stock of Champion on February 21, 1968. This is more than six months prior to his sale of a portion of that stock

on September 12. Since the transactions do not fall within the statutory period there can be no liability on defendant's part for any profit made.

The Statute of Frauds presents no problem in this case for the minutes of the Champion Board of Directors meeting, signed by the president, are sufficient writing to establish the terms of the contract. Defendant now seeks to charge the signatory corporation with those terms as of that date. Since the party to be charged herein has signed the minutes, the Statute of Frauds is satisfied; the contract is valid and enforceable. M.C.L.A. § 440.8319. The Statute of Frauds is no defense in this action.

Because there is no liability under § 16(b) of the Act, the court does not reach the other issues raised by defendant here, these questions being whether Unjust Enrichment is a valid defense to an action under § 16(b) of the Securities Exchange Act of 1934, whether the courts have retreated from the strict enforcement of § 16(b), whether summary judgment is proper when it has not yet been established whether defendant actually made a profit in the challenged transactions and whether an action under § 10(b) of the Act is a proper counterclaim in such an action.

Intervenor-plaintiffs' motion for summary judgment on the issue of liability is hereby denied. Defendant's motion for summary judgment of dismissal is hereby granted.

So ordered.

CHARLES W. JOINER
United States District Judge

Dated: Detroit, Michigan
January 11, 1973

APR 20 1974
MICHAEL RODAK, JR., CLE

IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-1479

ETSON B. JEFFRESS,

Petitioner,

—against—

JOSEPH L. KRAMER and BEATRICE F. KRAMER,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR INTERVENOR-PLAINTIFFS-RESPONDENTS IN OPPOSITION TO PETITION FOR CERTIORARI

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IN THE

Supreme Court of the United States

October Term, 1973

No. 73-1479

ETSON B. JEFFRESS,

Petitioner,

—against—

JOSEPH L. KRAMER and BEATRICE F. KRAMER,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR INTERVENOR-PLAINTIFFS-RESPONDENTS IN OPPOSITION TO PETITION FOR CERTIORARI

Intervenor-plaintiffs, Joseph L. Kramer and Beatrice F. Kramer, submit this brief in opposition to defendant's petition for certiorari. The decision below (A1)[1] is reported at 490 F.2d 611.

Counterstatement of Questions Presented

1. Did defendant purchase his shares (a) more than six months before their later sale, when the issuer, Champion, adopted a resolution approving a stock-for-stock acquisition

1. Citations with the prefix "A" or "B" are to pages of the appendices to the petition.

of defendant's company, subject to further negotiation; or (b) within six months of sale, when the parties completed negotiations and entered into a written agreement?

2. Should defendant be relieved of liability under § 16 (b) of the Securities Exchange Act merely because his short-swing profit-producing sale was part of a public offering under a registration statement—especially where the offering had been delayed by the selling group in order that interim bullish developments would enhance speculative interest and, accordingly, the proceeds of the offering?

3. Should recovery be denied because defendant obtained his shares from Champion as the purchase price for defendant's company?

Summary Statement of the Case

Plaintiff Champion Home Builders Co., a public company, sues Etson B. Jeffress, a director and officer, to recover a short-swing profit under § 16(b) of the Securities Exchange Act. The suit followed a demand by respondents, stockholders of Champion, who were later allowed to intervene. Thereafter intervenor-plaintiffs assumed the burden of prosecuting this case, including the appeal to the court below.

After extensive written and oral discovery, intervenor-plaintiffs moved for summary judgment in Champion's favor on the issue of liability. Defendant cross-moved for summary judgment of dismissal on a variety of grounds. The District Court (Joiner, J.) denied plaintiffs' motion and granted defendant's, finding that more than six months had elapsed between the purchase of defendant's shares and

their sale on September 12, 1968 (B15). According to the District Court, defendant purchased his shares on February 21, 1968 when Champion's board of directors adopted a resolution approving acquisition of defendant's company for 105,000 shares of Champion stock, subject to later negotiation of other terms and the parties' entry into a definitive agreement (B20).

Unanimously reversing, the Court of Appeals held that defendant remained uncommitted and acquired no incidents of ownership in the shares until April 17, 1968 when the parties arrived at a written agreement embodying all the terms (A4-A9). The appeal court also found that the "transaction gave rise not only to the potential for speculative abuse but also to actual abuse" (A11). These findings are fully supported by the record,[2] as will now appear.

Date of Purchase

Shortly before February 21, defendant and two officers of Champion had a handshake agreement that Champion would buy defendant's company, Concord, for 105,000 Champion shares (4).[3] No other terms were arrived at. Nothing was signed. On February 21 the Champion board adopted a resolution (A6) which "approved" such an exchange of shares of the two companies and authorized designated officers of Champion to negotiate and execute with defendant "an agreement and plan of reorganiza-

2. Inasmuch as the record consists of pleadings, documentary exhibits, answers to interrogatories and testimony by deposition, the "unless clearly erroneous" rule, F.R.Civ.P. 52(a), has no application; and the Court of Appeals was free to make its own findings. 5A J. W. Moore, *Federal Practice*, ¶ 52.04.

3. Figures in parentheses, without prefix or suffix, refer to pages in the petition.

tion." Defendant had yet to sign any paper relating to the transaction.

Negotiations then ensued between the parties and their attorneys (10a, 14a; Exh. 2, pp. 6, 9).[4] The transaction was consummated on execution of a 25-page "Agreement and Plan of Reorganization" on April 17, 1968 (Exh. 3).

Thereafter, on June 19, 1968, defendant was first elected a director and officer of Champion (7a, 17a). Assertions in the petition (4-5, 16) that defendant had been treated as a major stockholder and an insider since the February 21 board meeting have no record support.[5]

In his Form 3 report to the SEC (pursuant to § 16(a) of the Exchange Act), defendant set forth that he acquired his Champion stock on April 17—not February 21 (Exh. 11). All of Champion's statutory disclosure documents likewise set forth April 17 and not February 21 as the purchase date (Exh. 10, Item 2; Exh. 9, p. 4; Exh. 6, p. 12).

Nature of the Purchase Transaction

In an effort to invoke the pragmatic test for "unorthodox" transactions, *Kern County Land Co.* v. *Occidental*

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4. Citations with the suffix "a" are to pages of the Appendix filed in the Court of Appeals.
   Exhibits are in a binder marked "Exhibits," filed in the Court of Appeals.
   Mr. Sullivan, the author of Exh. 2, represented Champion in the negotiations; and Mr. Young was his associate. Mr. Bontrager was defendant's attorney.

5. Defendant was invited to join the February 21 board meeting (4), but only for the discussion relating to his company (Exh. 8, pp. 3-4). From that date until June 19, the record does not disclose any contact between defendant and Champion except by way of negotiation and (on April 17) consummation of the purchase transaction.

Petroleum Corp., 411 U.S. 582, 593-5 (1973), the petition (2, Question (2); 4; 5; 9; 11; 14; 16) repeatedly asserts or insinuates that defendant's transaction with Champion involved a merger. In truth there was no merger—only a purchase of stock in exchange for stock. Defendant's company, Concord, after acquisition of its stock by Champion, continued to operate as a separate corporation (Exh. 14, p. 2; Exh. 6, p. 3).

Potential for and Actuality of Speculative Abuse

The pragmatic test, moreover, even if it applied, would not avail defendant.

Defendant wanted a substantial part of the price being paid for his company to be in cash (44a-45a, 81a, 94a, 99a-100a), but a cash payment would have had tax disadvantages (45a). The parties' solution was to have defendant quickly dispose of about 25% of his to-be-acquired Champion shares in a public offering by Champion and its principal shareholders (82a-83a, 101a). This would also serve to reduce defendant's proportionate stock ownership in Champion, a condition imposed by its other large shareholders (58a).

Defendant and the other insiders all expected the market price of Champion stock to rise (Exh. 2, pp. 1-2; 83a, 102a). Grenier, a Champion officer, was put in charge of dealing with the underwriters and timing the offering (46a-47a). He was expected by all the insiders, including defendant, to time the offering so as to maximize the proceeds (id.). Grenier did his best (id.; 82a-85a).

Accordingly, the offering was delayed in order to await an improvement in Champion's earnings, expected by rea-

son of the phase-out of dealers' incentive programs and the pick-up of sales of Champion's revised product line (84a-85a). Defendant testified that he expected a price rise, based on his own knowledge of Champion's operations and its planned expansion program (102a-103a). Thus, when the offering was ultimately made, the registration statement was able to report enhanced earnings for the latest quarterly period ended May 31, 1968: 36¢ per share as against 10¢ for the corresponding 1967 period (Exh. 6, p. 4).

Furthermore, on June 19, 1968, at a meeting which first seated defendant as a director, the Champion board voted to split the stock two-for-one (Exh. 4, pp. 1-2).

The offering, by prospectus dated September 5, 1968 (Exh. 6), was a resounding success. On April 17, 1968, when defendant required his Champion shares, Champion stock was trading at around $44 per share (5). The public offering brought about $37 per split share (Exh. 6, p. 1). Defendant sold 50,000 of the split shares, about 25% of his position, in the public offering (6). The rise in market price between April 17 and September 5, $15 per split share, benefitted defendant to the extent of about $750,000—at the expense of the investing public which thereby paid that much more for defendant's shares.

The Registration Statement

Petitioner urges that he should escape liability because he sold under a registration statement.

When the registration statement became effective, the speculative abuse, at which § 16(b) is aimed, had already occurred. Defendant's shares had been withheld from sale in a rising market, in order to exploit unrevealed bullish developments.

The registration statement, true or false, was quite incidental. Insofar as it had market impact, the more that it revealed of theretofore undisclosed and favorable corporate developments, the better it suited defendant's speculative purpose and program.

Reason for Denying the Writ

The liability imposed below could hardly be clearer, in terms of both the letter and the purpose of § 16(b). There is no sound ground for review by this Court.

POINT I

Defendant did not acquire his shares until April 17, 1968, within six months of sale.

A purchase within the meaning of § 16(b) occurs when the insider is committed to take and pay for the shares. *Booth* v. *Varian Associates*, 334 F.2d 1 (1 Cir. 1964), *cert. den.* 379 U.S. 961 (1965); *Stella* v. *Graham-Paige Motors Corp.*, 232 F.2d 299 (2 Cir. 1956), *cert. den.* 352 U.S. 831. The purchaser must have both the right and obligation to buy; both parties must be bound. *Stella, supra*, at 301. In this case no such commitment arose until execution of the April 17, 1968 agreement (Exh. 3), which was less than six months before the sale.

The District Court's ruling (B18) that the February 21 Champion resolution bound the parties is unsupported by any principle of contract law or other authority.[6] It is also

6. *Shattuck Denn Mining Corp.* v. *LaMorte*, CCH Fed.Sec.L.Rep. ¶ 94,429, p. 95,473 (D.N.Y. 1974), involving a similar directors' resolution, is a recent 16(b) ruling on the point, contrary to the District Court's in our case.

at odds with the later declarations of the parties, including defendant's Form 3 report to the SEC (Exh. 11), p. 4, *supra.*

Statements in the petition (4-5, 16) that defendant enjoyed insider status since February 21 are mere assertion. Defendant was a rank outsider until at least April 17; see footnote 5, *supra.* Until that date, furthermore, he had no shares to sell, even if it be assumed that he had access to inside information. Dating defendant's 13% stock ownership (4) from February 21 would, in effect, reduce the statutory quarantine from six months to four: Between February 21 and April 17, defendant's relationship to Champion was too tenuous to provide him with either the means or the opportunity to engage in the interdicted conduct.

POINT II

The purchase was "orthodox".

The petition (9) submits that the ruling below is inconsistent with *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582 (1973). This argument, which is central to the petition, rests on the assumption that defendant's purchase involved a merger. We have already seen, pp. 4-5, *supra*, that this is not so. Defendant bought his Champion shares with shares of his own company. It has repeatedly and uniformly been held that there is no distinction, for § 16(b) purposes, between a voluntary purchase of stock for stock as against one for cash. *Booth* v. *Varian Associates*, 344 F.2d 1 (1 Cir. 1964), *cert. den.* 379 U.S. 961 (1965); *Blau* v. *Lamb*, 242 F.Supp. 151, 155 (D.N.Y. 1965), *rev'd on other grounds*, 263 F.2d 507 (2

Cir. 1966); *cert. den.* 385 U.S. 1002 (1967); *Marquette Cement Mfg. Co.* v. *Andreas*, 239 F.Supp. 962, 966 (D.N.Y. 1965); *Fistel* v. *Christman*, 135 F.Supp. 830 (D.N.Y. 1955); *Stella* v. *Graham-Paige Motors Corp.*, 132 F.Supp. 100, 102-3 (D.N.Y. 1955), *aff'd* 232 F.2d 299 (2 Cir. 1956), *cert. den.* 352 U.S. 831; *Blau* v. *Hodgkinson*, 100 F.Supp. 361, 373 (D.N.Y. 1951).

Such a transaction presents none of the statutory ambiguity and consequent problems which confronted this Court in *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582 (1973), and were the focus of the decisions and commentaries cited in footnote 26 to the prevailing opinion. Defendant's voluntary transaction left him in precisely the same position that he would have occupied had he bought for cash—i.e., a 13% shareholder (4) and, soon thereafter, a director and officer of Champion to boot. He was under no compulsion to sell and could have avoided liability simply by postponing sale for another five weeks. "Instead," as observed by the Court of Appeals (A12), "he chose to maximize his profits as early as possible."

POINT III

The sale likewise was "orthodox" and was not rendered any less so because it was made under a registration statement.

Defendant's sale, like his purchase, was entirely voluntary. The time picked for the public offering was agreeable to all members of the selling group, including defendant (47a-48a). Defendant approved the offering as a Champion director (Exh. 4, pp. 1, 3-6). He signed the registration statement (Exh. 7, p. 2).

Defendant nonetheless contends that § 16(b) would be unfairly or inappropriately applied because the sale was under a registration statement.

We have already noted, pp. 5-6, *supra*, that the speculative abuse in this case lay in the timing of the public offering. With relation to the investing public, the damage had already been done when the registration statement with its bullish disclosures became effective. The registration statement helped, rather than hindered, defendant's use of inside information for personal profit. Why, then, should it have any exculpatory consequence?

There are, moreover, broad and compelling reasons that sale under a registration statement should not be given exemptive effect:

1. The Securities and Exchange Commission, although empowered to do so, § 16(b) last sent., has declined to provide any such exemption.

2. Section 16(b)[7] in terms applies only to securities that are registered under § 12 of the Exchange Act, 15 U.S.C. § 78(1). Issuers of such securities are subject to the recurring disclosure requirements of the proxy rules, Exchange Act § 14(a), 15 U.S.C. § 78(n)(a), as well as to the periodic reporting requirements of § 13 of the Act, 15 U.S.C. § 78(m). These provisions generally call for prompt and full revelation of significant corporate transactions and events. If revelation by registration statement were to be given exemptive effect, it would be difficult to distinguish revelation by proxy statement, by current Form 8-K report, by quarterly Form 10-Q report, by annual Form 10-K

7. As qualified by § 16(a).

report, and by other such filings and documents. § 16(b) would be virtually nullified by judicial fiat. At best, instead of the clear-cut sanction envisaged by Congress,[8] litigation to enforce the statute would be mired in *ad hoc* analyses of the truth and adequacy of the contemporary disclosures.

3. No disclosure document could realistically approximate the information available to an active corporate insider (like defendant in this case). For example, management's expectations as to future earnings and dividends, continually studied in the executive suite, seldom find their way into registration statements and other disclosure materials. Misuse of this kind of inside information is just what the statute is aimed at.

Recent decisions imposing § 16(b) liability for profit-producing sales under registration statements include *Brenner* v. *Career Academy, Inc.*, 467 F.2d 1080 (7 Cir. 1972), and *Allis-Chalmers Mfg. Co.* v. *Gulf & Western Industries, Inc.*, CCH Fed.Sec.L.Rep. ¶ 74,421, p. 95,434 (D.Ill. 1974). We find no case, and defendant cites none, where a defendant was relieved of § 16(b) liability because the sale was under a registration statement.

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8. See *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582, 592-3 (1973).

POINT IV

In view of the potential for and actuality of speculative abuse, liability should be imposed even if the transaction was unorthodox.

Assuming, *arguendo*, that defendant has raised a substantial question as to whether his acquisition of Champion shares was a "purchase" or his sale was a "sale" within the intendment of § 16(b), there would still be no controversy to detain this Court because this case so plainly presents not only the potentiality for but the actuality of speculative abuse. See pp. 5-6, *supra*.

Passing defendant's contention that he acquired his shares under a corporate resolution which merely authorized further negotiations, the most that can be said for defendant's position, and indeed all that defendant asserts, is that one or both of his "purchase" or "sale" were "unorthodox." Conceding this, liability still follows merely because of the potential for speculative abuse. *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582, 593-5 (1973).

There is no need to go beyond the fact that defendant served continuously as an active director and officer of the issuing company for almost three months before the profit-producing sale.

POINT V

Champion's "unjust enrichment" is not a defense.

Section 16(b) was not enacted to redress corporate injuries but to protect the investing and trading public. *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582, fn. 23 (1973). The statute places the recovery in the corporation merely as a matter of expediency. As stated in *Jefferson Lake Sulphur Co.* v. *Walet*, 104 F.Supp. 20, 23 (D.La. 1952), an early and frequently cited case for the proposition that a corporation cannot be estopped to enforce a § 16(b) claim:

> "In other words, in order to protect minority shareholders and the public who have no control over the management of the corporation, Section 16(b) uses the corporation as an instrument, sometimes an unwilling instrument, by which the officer or director is forced to disgorge his short term profits."

"Unjust enrichment" of the issuing company is commonplace in § 16(b) actions. It has never been held to relieve the insider of liability or in any way to mitigate his accountability. The leading case is *Magida* v. *Continental Can Co.*, 231 F.2d 843 (2 Cir. 1956), *cert. den.* 351 U.S. 972.

Defendant complains that a recovery will have the effect of altering his bargain by reducing the price which he was to get for the company he sold to Champion. This argument got short shrift in *Roth* v. *Fund of Funds, Ltd.*, 405 F.2d 421, 422-3 (2 Cir. 1968), *cert. den.* 397 U.S. 75 (1969), *and Schur* v. *Salzman*, 365 F.Supp. 725, 733 (D.N.Y. 1973).

CONCLUSION

The petition for a writ of certiorari raises no question meriting review by this Court and it should be denied.

Dated: April 19, 1974

Respectfully submitted,

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